

STUDENT SYMPOSIUM: THE FRANCHISE RELATIONSHIP—ABUSES AND REMEDIES

Franchising has experienced a phenomenal growth during the past decade, and this growth has been accompanied by a steady attack on the franchising scheme itself. Although generally acclaimed as the last real hope for maintaining the existence of the small businessman in the United States, franchising has been used by the unscrupulous to raise money by fraudulent means for their personal coffers. The frauds and abuses vary with the ingenuity of the human mind, but the two major abuses have been (1) fraudulent statements by franchise promoters to induce prospective franchisees to invest in a marketing system devised and operated presumably for the common benefit of the two parties to the franchise agreement, and (2) unjustified unilateral terminations of the franchise relationship which typically result in severe economic hardship or disaster for the franchisee. More recently, there has been a growing concern with the economic coercion used by the franchisor to compel franchisees to comply with the policies and mandates of the franchisor organization.

The lead article by Harold Brown, which precedes this student symposium, indicates and analyzes several of the problems and abuses inflicted upon franchisees as a result of fraud, concealment and non-disclosure by franchise promoters. Mr. Brown, author of *Franchising: Trap for the Trusting*,¹ is a leading proponent of legislation to regulate the initial sale, operation and termination of franchises. The student articles begin with a discussion of proposed legislation to protect franchisees with an emphasis on the current proposal before the Ohio legislature. In the second article, the reader is exposed to a case study of a pyramid franchising scheme which has recently been subjected to litigation nationwide. The third student article analyzes one procedure used by franchisors to terminate unwanted franchisees, and finally, the categorization of a franchise as a security is discussed and analyzed.

One caveat is due the reader of any article discussing franchising and its related abuses. The major problem encountered by commentators, whether they be proponents or opponents of franchising, has been the definition of the term "franchise." Litigants and commentators have variously attempted to characterize the franchise as a pure contract, as an agency or employment relationship and as a security, and thereby to make any existing legal theories readily available to support the particular legal remedy they seek to invoke. Lewis G. Rudnick, a chief proponent of franchising and counsel for a franchisor trade association suggests that the franchise relationship is a "hybrid business relationship which is *sui*

¹ H. BROWN, *FRANCHISING: TRAP FOR THE TRUSTING* (1969).

generis in law" and subject to several legal theories. Mr. Rudnick has used a story about Charles Darwin to illustrate his point.

Darwin was once the house guest of a friend whose two small boys decided to play a joke on him. They took a centipede and glued to it a beetle's head, a butterfly's wings and a grasshopper's legs. Then showing it to Darwin, they innocently asked, "Mr. Darwin, what kind of bug is this?" Darwin looked at it solemnly. "Did it hum when you caught it, boys?" he inquired. "Yes, sir, it did," the boys answered. "That's it," said Darwin triumphantly. "It's a humbug."²

And so, like the creature created by two young, but inventive, minds the franchise may be viewed as a new breed of business relationship which now generates approximately \$100 billion in annual sales or ten percent of all gross sales in the United States.

This "new breed" of business has been defined by the California legislature in the Franchise Investment Law of 1971, as follows:

[A] contract or agreement, either expressed or implied, whether oral or written, between two or more persons by which: a franchisee is granted the right to engage in the business of offering, selling or distributing goods or services under a marketing plan or system prescribed in substantial part by a franchisor . . . the franchisee's business pursuant to such plan or system . . . substantially associated with the franchisor's trademark, service mark, trade name, logotype, advertising or other commercial symbol designating the franchisor or its affiliate.³

The California act is quickly becoming the prototype statute since it is being duplicated by the various states. It should be noted that the act begins with the term "contract," but remember also that the courts and legislatures have often been willing, sometimes eager, to restructure the independently produced contract or to superimpose statutory law in order to advance some public interest. Being unsatisfied with the court's approach to franchising abuses, several legislatures have begun to enact statutes to regulate various aspects of the franchising relationship. The new statutes, however, do not address themselves to all of the emerging problems encountered by parties to a franchise agreement. The laws of contracts, antitrust, agency, securities and numerous other legal categories will no doubt remain applicable to franchising just as they remain applicable to corporations and partnerships. With this definitional problem in mind, it is our purpose and hope that the reader will become familiarized with several of the current problems facing the franchising system and the proposals for reform that are now being debated at both the federal and state levels.

² Rudnick, *A Review of Legal Problems of Franchising in the United States for the European Franchisor*, at 3, (October, 1971) (unpublished manuscript, a copy of which is on file in the Ohio State Law Journal office).

³ CAL. CORP. CODE §§ 31000-31516 (West Supp. 1972).